SUPREME COURT, U. S.

No. 909

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IN THE

Supreme Court of the United States

OCTOBER TERM, 1966.

EDWARD LIMPERIS, TRUSTEE IN BANKRUPTCY OF PROCESS-MANZ PRESS, INC.,

Petitioner,

vs.

A. J. ARMSTRONG CO., INC.,

Respondent.

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

BRIEF FOR RESPONDENT IN OPPOSITION.

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ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE SEVENTH CIRCUIT.

CITATION TO OPINION BELOW.

The opinion of the court below is reported in 369 F. 2d 513.

The judgment of the Court of Appeals was entered on July 29, 1966. Rehearing *en banc* was denied on October 3, 1966 by a vote of 7 to 1.

THE STATUTES INVOLVED.

Petitioner incorrectly implies that the only statutory provision involved is § 2a(7) of the Bankruptcy Act, 11 U. S. C. A. § 11a(7). The fact is, however, that § 23b of the Bankruptcy Act, 11 U. S. C. A. § 46(b), is more directly involved and provides:

"(b) Suits by the receiver and the trustee shall be brought or prosecuted only in the courts where the bankrupt might have brought or prosecuted them if proceedings under this title had not been instituted, unless by consent of the defendant, ..."

QUESTION PRESENTED.

Although petitioner states that several questions are presented for consideration by this Court, actually there is only one question before this Court, namely: when summary jurisdiction is timely challenged by an adverse claimant in possession, whose claim is clearly substantial, may the bankruptcy court refuse under the well established law to conduct a preliminary inquiry to determine whether the adverse claim is real and substantial or merely colorable, and instead, over the persistent objections of the adverse claimant, insist on conducting an immediate trial on the merits which involve complicated issues of law and fact?

STATEMENT OF THE CASE.

Since petitioner's statement of the case is inaccurate and incomplete, respondent sets forth its statement of the facts material to the consideration of the question presented.

Respondent's Secured Claims.

Commencing with December 14, 1961, A. J. Armstrong Co., Inc. (respondent), made loans to the bankrupt in excess of $2,700,000 on the security of the bankrupt's real estate and equipment (R. 382-393, 398, 1085, 1143, 1152, 1169—par. 2, 1215, R. Vol. V 45-48, 49-52, 53-57, 61, 62-66, 67, 68-73). Respondent also made accounts receivable loans aggregating $5,600,000 (R. 396) on which at the date of bankruptcy there was a balance due in excess of $1,085,888 (R. 398). On November 21, 1962, when respondent took

actual adverse possession, the bankrupt owed respondent $3,764,724 (R. 398). The bankrupt in its schedules filed in the bankruptcy proceeding admitted respondent was a secured creditor in the aggregate sum of $3,742,965 and that its claims were neither contingent nor disputed (R. 39-40).

Petitioner has never disputed the amount of the loans made by respondent.

Respondent's Adverse Possession Taken After Defaults.

On November 21, 1962, two days prior to the filing of the involuntary bankruptcy petition, the bankrupt had been in default for several months (R. 400, 405) in its obligations to respondent. On that date respondent, to protect its collateral (R. 405), and in accordance with law, took peaceful, exclusive, adverse, physical possession of the building and equipment which was the security for its loans (R. 439, 472-483, 542-47, 557-58, 618-22). Some of the bankrupt's defaults which necessitated respondent's protective action were the following:

(a) the bankrupt's failure for five consecutive months to make its monthly payments then aggregating $230,000 (R. 400, 1083);

(b) the existence of unpaid judgments for substantial sums (R. 404, 1335, 1339);

(c) the pendency of a replevin action (R. 1307);

(d) threats of levies by judgment creditors (R. 404-05, 1303-08);

(e) the pendency of law suits by creditors having substantial unpaid claims (R. 404-05, 1303-08, 1340);

(f) threat of cancellation of insurance covering the bankrupt's property (respondent's security) because of non-payment of premiums (R. 1307); and,

(g) threat of a strike because of bankrupt's non-payment of sums due to the union health and welfare fund (R. 1308).

On November 23, 1961, the involuntary petition in bankruptcy was filed (R. 1). Respondent's actual possession of its collateral was admitted in three different documents filed by the petitioning creditors and other creditors (R. 14, 1299, 1301-02).

On November 26, 1962, five days after respondent took possession, the receiver was appointed but did not attempt to remove respondent or take possession of the building or equipment (R. 8, 457-58, 519, 528).

Respondent's Agreement With the Receiver.

On the evening of November 27, 1962, respondent pursuant to a detailed agreement (R. 22-24) with the receiver and creditors holding approximately fifty per cent of the general unsecured claims, permitted the receiver conditional entry and use of the building and equipment. The terms and conditions of that agreement are admitted by the receiver and set out in his petition filed December 6, 1962 (R. 20-27). The agreement, *inter alia,* expressly provides that if an order of adjudication in bankruptcy is entered, the receiver shall restore respondent to its possession, and respondent's rights as adverse claimant shall be determined as of the date of bankruptcy which was two days after respondent had taken adverse possession (R. 22-23).

The Referee's Order of December 7, 1962.

On December 7, 1962, the referee entered an order (R. 35) on the receiver's petition (R. 20-27). The order, *inter alia,* provided (R. 36):

> "IT IS FURTHER ORDERED that . . . the rights and questions of jurisdiction as to, and possession of A. J. Armstrong Co., Inc. shall be considered and determined in all respects as of the time of filing of the above [bankruptcy] proceedings. . . ."

Receiver's Refusal to Honor His Agreement.

On January 31, 1963, an order of adjudication in bankruptcy was entered and respondent demanded return of possession in accordance with its agreement with the receiver (R. 1297-98). The receiver refused to honor his agreement. On February 4, 1963, the receiver filed a petition to sell respondent's collateral, and an order was thereupon entered directing respondent to assert within ten days its right, title and interest in said property or be forever barred and enjoined from claiming any interest therein (R. 50-57, 58-59).

Respondent's Motion Challenging Summary Jurisdiction and Referee's Refusal to Conduct Preliminary Inquiry.

On February 14, 1963, in response to the referee's order of February 4, 1963, respondent filed its motion challenging summary jurisdiction. This motion, *inter alia,* incorporated the promissory notes and mortgages held by respondent; set forth respondent's adverse possession for two days prior to and at the date of bankruptcy; referred to its November 27, 1962 agreement with the receiver, and prayed that since the receiver refused to honor his agreement that respondent be deemed to have been in continuous adverse possession (R. 60-73).

On April 1, 1963, at the commencement of the hearings on respondent's motion challenging summary jurisdiction, respondent cited the controlling decisions of this Court, namely, *Harrison* v. *Chamberlin,* 271 U. S. 191 (1926); *Cline* v. *Kaplan,* 323 U. S. 97 (1944) and *Mueller* v. *Nugent,* 184 U. S. 1 (1901), and respectfully urged that the referee conduct a preliminary inquiry to determine whether respondent's adverse claim was real and substantial or merely colorable (R. 369-376). This the referee refused to do.

Instead, on that date and at all times thereafter, despite the persistent objections of respondent, the referee continued to refuse to conduct a preliminary inquiry and insisted that he was going to hear "all of the evidence" in the entire case (R. 372, 470, 984-85, 989, 1043). On August 6, 1963, the referee stated (R. 989-990):

> "The Referee: I think that certainly I have made it clear, and I don't want anyone to be misled, or in the dark on it by my rulings and by things that I have said. I have indicated very clearly that I wanted to hear all of the evidence in this case.
>
> "I don't recognize now, *nor have I at any time,* that the only factual issue was one of possession. I am aware of the question that has been raised with respect to jurisdiction, but I nevertheless am ruling, and have said that I want to, and intend to hear all of the evidence. Now, this means just exactly what I have said,—*all of the evidence.*
>
> "Most certainly, without in any way jeopardizing any positions that anybody has taken, I still persist and I insist, if you have got evidence to offer, offer it and put it in, and this applies to both Armstrong and the Trustee. And, when *all of the evidence is in and the matter is closed, then I will consider the whole, the entire matter. I don't intend to make any rulings of any phase of the matter until all the evidence is in, and I think that I made this very clear right from the outset. If I didn't I am doing so now.*
>
> "I don't expect that you necessarily agree with this procedure or this approach, but I am convinced in my own mind that this is part of the responsibility that I have in this case, and I therefore am going to hear all of the evidence.
>
> "Mr. Nachman: We have, from the very commencement of this proceeding, respectfully disagreed with the Court in this respect, and we should like the record to show we continue, respectfully, to disagree with the Court.
>
> "It is Armstrong's feeling that this hearing has been continued way beyond the scope authorized by the

cases on the subject, and this should have been a preliminary inquiry to ascertain whether or not Armstrong's claim of adverse possession is purely (or simply colorable, or whether it has substance in fact.

"All I can say, your Honor, is with the greatest respect for the Court, we just disagree.

"The Referee: I think you have made your position clear. I think the record reflects this and *I still say that I am going to conclude the matter on the premise that I originally adopted, and that is it.* You may guide yourselves accordingly.

"I say, I may be right or wrong, but I feel this is the proper way to do it and I intend to do it this way.

"There you have it, gentlemen. There can't be any misunderstanding with respect to this, I trust." (Emphasis ours.)

On October 17, 1963, respondent objected to petitioner's introduction in evidence of certain depositions because they were immaterial and irrelevant to the jurisdictional objection before the court. The referee again reaffirmed his determination to hear "all of the evidence" before ruling on respondent's objection to jurisdiction (R. 1043):

"The Referee: Are the objections you made in the depositions the same as you have been making here?

"Mr. Nachman: Yes, Your Honor.

"The Referee: I don't think it is necessary then, at least for my convenience, to refer specifically to page numbers. I haven't read the depositions, but if the statement of objections is as you say, then I will say *it was my original announced intention that I would hear all of the evidence.*

"These objections are overruled and the documents will be admitted." (Emphasis ours.)

Throughout the extended hearings from April 1, 1963 to October 24, 1963, respondent repeatedly asserted its objections to summary jurisdiction and urged that a preliminary

inquiry be conducted.* Respondent's objections were overruled.

Respondent Limited Its Evidence to Summary Jurisdiction.

Respondent limited its participation in the hearings to its introduction of evidence and cross-examination of witnesses on its jurisdictional objection and to establish that its adverse claims were real and substantial.

The Orders of the District Court and the Referee.

It was not until November 27, 1963, eight months after the start of the hearings on respondent's motion challenging jurisdiction, that the referee overruled respondent's objections to summary jurisdiction and in the same order made voluminous findings of fact on the merits of respondent's claims and ordered that its secured claims for $3,764,724 be subordinated to the claims of all unsecured creditors (R. 153-199). On December 2, 1963, the referee entered an order authorizing the petitioner to sell respondent's collateral (R. 199-202). The sale was stayed upon approval of respondent's supersedeas bonds (R. 330).

On December 20, 1963, respondent filed its petition to review the referee's orders of November 27, 1963 and December 2, 1963 (R. 208-299).

On December 4, 1964, the district court denied the petition for review and affirmed the referee's orders (R. 331-363).

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* Record pages: 109, 147, 151, 369-373, 418, 419, 420, 426, 429-433, 467, 468-471, 582, 586, 587, 589, 592, 597, 598, 604, 605, 607-08, 609, 666, 667, 673, 729, 730, 776, 777, 799, 823, 840, 856, 862, 882, 883, 901, 931, 942, 950, 955, 976, 980, 988, 989, 1000, 1013, 1015, 1016, 1019, 1029, 1030, 1032, 1033, 1034, 1035, 1036, 1037, 1041, 1042, 1043, 1045, 1046, 1060, 1404, 1573, 1629, 1632, 1665, 1668.

Petitioner's Pending Plenary Action.

On January 29, 1965, petitioner filed a plenary action against respondent seeking the identical relief sought by him in the summary proceedings (R. 1063-73). This action is still pending in the United States District Court for the Northern District of Illinois, Eastern Division. On February 18, 1966 respondent filed its answer denying petitioner's claims and also filed counterclaims against the bankrupt, the petitioner and third parties seeking, among other things, foreclosure of its mortgages (R. Vol. V, 21-34) and payment by petitioner of moneys which he failed to remit pursuant to court order (R. Vol. V, 35-38). On February 28, 1966 respondent also filed a third party complaint against former officers, directors and shareholders of the bankrupt for fraudulently inducing respondent to make its loans to the bankrupt (R. Vol. V, 94-116).

On December 13, 1966, ten months after respondent filed its third-party complaint, petitioner amended his complaint in the plenary action to include a claim against certain of the former officers, directors and shareholders of the bankrupt for misappropriation of $1,438,555 of the proceeds of respondent's loans to the bankrupt; a copy of petitioner's amended complaint is printed in Appendix A hereto, *infra* p. 29.

Respondent has demanded trial by jury in the plenary action (R. Vol. V, 2, 105).

The Decision of the Court of Appeals.

The Court of Appeals reversed the order of the district court and held that the bankruptcy court did not have summary jurisdiction over respondent and directed the parties "to proceed expeditiously" with the pending plenary action.

The Evidence Supporting Respondent's Secured Claims on the Merits Will Be Presented in the Pending Plenary Action.

Respondent denies petitioner's statement of alleged facts relating to the merits of respondent's claims. As is clear from the opinion of the Court of Appeals, respondent has not yet had its day in court on the merits of its claims. Therefore, the record does not contain the evidence concerning the merits of respondent's claims. This evidence will be fully presented in the pending plenary action.

ARGUMENT IN OPPOSITION TO THE PETITION FOR WRIT OF CERTIORARI.

I.

There Is No Support for the Petition.

This was an important case below only because the referee and the district court refused to follow the well established law repeatedly announced by this Court. In *Harrison* v. *Chamberlin,* 271 U. S. 191 (1926); *Mueller* v. *Nugent,* 184 U. S. 1 (1901); *Cline* v. *Kaplan,* 323 U. S. 97 (1944); and *Taubel-Scott-Kitzmiller Co.* v. *Fox,* 264 U. S. 426 (1924), this Court held: when an adverse claimant in possession challenges the summary jurisdiction of the bankruptcy court, the referee before engaging in an extended trial on the merits must first conduct a preliminary inquiry to determine whether or not the adverse claim is real and substantial or merely colorable, and once it is established that the claim is neither colorable nor frivolous, the referee must decline to determine the merits and dismiss the summary proceedings. The Court of Appeals (rehearing *en banc* denied 7 to 1) in reversing the district court held that the law established by this Court must be followed.

Petitioner fails to demonstrate any conflict between circuits because none exists. The question presented below was neither new nor novel. The law applicable to the question was established long ago and repeatedly reaffirmed by this Court, and it has been consistently followed in all the circuits.

II.

Petitioner Concedes Respondent's Adverse Possession and the Substantiality of Its Secured Claims.

It is impossible to detect from the petition that the real issues in this case are and always have been respondent's actual adverse possession of its collateral taken two days prior to bankruptcy and the substantiality of its secured claims which, under the established law, required the referee to conduct a preliminary inquiry and rule promptly on the jurisdictional objection. Petitioner does not now nor has he ever denied that respondent took actual adverse possession of its collateral two days prior to bankruptcy, or that it has secured claims for $3,764,724. The petitioner is significantly silent on these vital issues. It was on these undisputed facts, namely, respondent's adverse possession and the substantiality of its claims, that the Court of Appeals reversed the district court.

Since petitioner concedes the real issues in the case, clearly there is no basis or support for his petition for a writ of certiorari.

III.

Petitioner's Pending Plenary Action Provides the Only Means for Determining in One Trial All the Rights and Claims of All the Parties.

In reversing, the Court of Appeals directed that the parties proceed expeditiously in the pending plenary action. In that action petitioner challenges respondent's claims on their merits, and respondent has filed its answer and counterclaim and a third party complaint against former officers, directors and shareholders of the bankrupt for possible fraud and deceit.

Significantly, at respondent's persistent urging, petitioner on December 13, 1966 belatedly joined as additional

parties defendant in the plenary action some of the former officers, shareholders and directors of the bankrupt, charging them with unlawfully appropriating for their personal benefit $1,438,555, being part of the proceeds of respondent's loans to the bankrupt (Appendix A hereto, *infra* p. 40-42). Petitioner will not deny that one of those newly named defendants, Lester Neumann, is a long-time client of the law firm of Collen & Kessler and a long-time business partner of Mr. Louis I. Kessler, a member of that firm (R. 672). Mr. Collen of Collen & Kessler is the attorney for petitioner. Unfortunately for the creditors of the bankrupt estate, it was too late on December 13, 1966 for petitioner to join other former officers, directors and shareholders of the bankrupt as defendants, namely, Mr. Louis I. Kessler and his wife, because petitioner had permitted the statute of limitations to run against them. However, respondent by timely filing its third party complaint, was able to make all the former officers, directors and shareholders, including the Kesslers, parties defendant in the plenary action.

The pending plenary action avoids multiplicity of suits and useless, expensive duplication of voluminous evidence and provides the only means for an expeditious determination of all the issues. That action also provides the only means for determining whether or not the former shareholders, directors and officers of the bankrupt misappropriated $1,438,555 as belatedly charged by petitioner, or whether those persons are guilty of fraud and deceit as charged by respondent.

IV.

The Court of Appeals in Reversing Followed the Decisions of This Court.

Petitioner asserts (Petn. 14, 15) that the opinion of the Court of Appeals is "erroneous" and "perplexing". The fact is, however, that the Court of Appeals reversed because the referee and district court refused to follow the law established by this Court. Obviously, the decision of the Court of Appeals is neither erroneous nor perplexing; it is the action of the referee and the district court that may be appropriately so characterized.

On the clear authority of *Harrison* v. *Chamberlin,* 271 U. S. 191 (1926) and *Cline* v. *Kaplan,* 323 U. S. 97 (1944), the Court of Appeals held that the referee erred in insisting from the outset and over respondent's objections, on conducting a full trial instead of conducting a preliminary inquiry. The referee's statements quoted at pages 6 and 7 of this brief clearly establish that he at all times refused to conduct the required preliminary inquiry. The Court of Appeals properly concluded that the referee, early in the proceedings, should have sustained the objections to summary jurisdiction because respondent had then established that its claims were real and substantial.

Petitioner does not attempt to distinguish *Harrison* v. *Chamberlin,* 271 U. S. 191 (1926), *Cline* v. *Kaplan,* 323 U. S. 97 (1944), *Mueller* v. *Nugent,* 184 U. S. 1 (1901), and *Taubel-Scott-Kitzmiller Co.* v. *Fox,* 264 U. S. 426 (1924). Rather, petitioner argues *Harrison* v. *Chamberlin,* one of the cases cited by the Court of Appeals, is "obsolete". This argument is without merit. It should be noted that the Court of Appeals also cited *Cline* v. *Kaplan,* 323 U. S. 97 (1944), wherein this Court reaffirmed the rule announced in *Harrison.* And as recently as 1966, in *Katchen* v. *Landy,* 382 U. S. 323, this Court cited *Cline* and *Taubel-*

Scott-Kitzmiller with approval and in footnote 9 of its opinion said that its decision in *Katchen* was governed by traditional bankruptcy law. Obviously there is nothing in *Katchen* which even remotely supports petitioner's contention that the well established rule of bankruptcy law on summary jurisdiction has been rendered obsolete.

It is also important to note that when this Court was considering *Katchen*, it denied the petition for certiorari in *Suhl* v. *Bumb*, 348 F. 2d 869 (C. A. 9, 1965), cert. denied, 382 U. S. 938 (1965). The similarity between *Suhl* and our case is striking, indeed. In *Suhl*, the referee, over the objection of the adverse claimant, conducted lengthy hearings on the merits and concluded among other things that the adverse claimant was guilty of fraud, was the alter ego of the debtor corporation, and that its claims were frivolous, colorable and not bona fide. There, too, the district court affirmed. The Court of Appeals reversed and held that despite the voluminous findings and conclusions of the referee, the bankruptcy court lacked summary jurisdiction, and it was necessary for the trustee to proceed by plenary action. Clearly, the most recent decisions of this Court establish that the rule of *Harrison* is not obsolete.

Petitioner argues (Petn. 10-12) that the long established distinction between summary and plenary jurisdiction in bankruptcy cases should be judicially abolished. This distinction was not created by judicial decree, but was enacted by Congress in the Bankruptcy Act of 1898. Sec. 23b of the Bankruptcy Act provides that the bankruptcy court, absent consent, does not have summary jurisdiction over an adverse claimant in possession. *Taubel-Scott-Kitzmiller Co.* v. *Fox*, 264 U. S. 426, 431 (1924); *Katchen* v. *Landy*, 382 U. S. 323 (1966), and *MacDonald* v. *Plymouth County Trust Co.*, 286 U. S. 263, 266 (1932).

It is respectfully submitted that any suggestion for repeal of § 23b must be addressed to Congress. Significantly, in

1952, when Congress amended § 2a(7) of the Bankruptcy Act, thereby requiring challenges to summary jurisdiction to be asserted within the time permitted for pleading, it did not see fit to modify or repeal § 23b.

V.

The Decision of the Court of Appeals Will Prevent Further Delay and Waste.

There is no support for petitioner's argument (Petn. 12-13) that the decision of the Court of Appeals fosters delay and waste in bankruptcy administration. The Court of Appeals specifically held that it was not the respondent but rather the referee who was responsible for the delay because he failed to dismiss the summary proceeding at the proper stage. Petitioner cannot shift the responsibility from the referee to the Court of Appeals.

The Report of Judge Sanborn, cited by petitioner (Petn. 13), is in fact support for the decision of the Court of Appeals and would place the responsibility for waste and delay on petitioner. In the Committee Report to The National Judicial Conference, August 21, 1944, quoted in *MacLachlan's Handbook On The Law of Bankruptcy*, § 194, n. 24 p. 208 (1956), Judge Sanborn and his committee stated:

> "Particularly when the case goes to the Court of Appeals upon a challenge to the propriety of a ruling as to whether summary proceedings lie, much time and money have been wasted by failure to initiate plenary proceedings in the first place."

As the Court of Appeals found, respondent's efforts to avoid delay and waste are clearly established by the record.

It is evident that the claims and rights of the various parties involved in this litigation cannot be determined in a summary proceeding. As was noted above, respondent in the plenary action has joined the former officers, share-

holders and directors of the bankrupt, charging that they may be guilty of fraud and deceit in connection with respondent's loans to the bankrupt. Petitioner, as trustee in bankruptcy, after repeated insistence by respondent, belatedly also joined some of these people as parties defendant in that action. The rights of, and claims against, most of the parties to the plenary action cannot be adjudicated in the summary proceeding because they are not parties to the summary proceeding. The fallacy of petitioner's argument is, therefore, apparent. Despite the summary proceeding, on the undisputed record in this case, petitioner, if he genuinely intends to enforce the bankrupt estate's claims against the former officers, shareholders and directors for misappropriating $1,438,555, must and should be eager to proceed in his plenary action.

The importance of the ruling of the Court of Appeals lies in the hope that it will serve to avoid in future cases the waste and delay which unnecessarily occurred here and which petitioner strangely still seeks to extend.

Petitioner erroneously argues (Petn. 15) that the decision of the Court of Appeals will result in suspension of the administration of the bankrupt estate until respondent's claims are adjudicated in the pending plenary action. There is no basis for this argument. The fact is that there has been no cessation in the administration of the estate since the ruling of the Court of Appeals. In rejecting the illegal procedure of the referee, the Court of Appeals directed that except as to the adverse rights and claims of respondent, the bankruptcy court should exercise its summary jurisdiction in the administration of the estate. In support of its ruling in this regard the Court of Appeals cited *Thompson* v. *Magnolia Petroleum Co.*, 309 U. S. 478, 483 (1940).

VI.

There Is No Conflict Among the Circuits.

It should be noted that petitioner does not contend that a conflict in fact exists between the decision of the Court of Appeals and most of the cases cited by him. As to those cases, the most that petitioner appears able to say is that they conflict "in principle" with the decision in this case. Some of such cases are: *Giffin* v. *Vought*, 175 F. 2d 186 (C. A. 2, 1949); *Ullman, Stern & Kraussee* v. *Coppard*, 246 Fed. 124 (C. A. 5, 1917); *Johnson* v. *Wilson*, 118 F. 2d 557 (C. A. 9, 1941); *O'Dell* v. *United States*, 326 F. 2d 451 (C. A. 10, 1964), and *Continental Cas. Co.* v. *White*, 269 F. 2d 213 (C. A. 4, 1959). These cases are inapplicable because there the claimants unquestionably submitted voluntarily to summary jurisdiction. Moreover, it must be noted that respondent has never had its day in court on the merits of its adverse claims for $3,764,724. The improper findings of fact and conclusions of law on the merits made by the referee, clearly were not necessary for determination of respondent's objections to summary jurisdiction. The Court of Appeals concluded that since respondent established its adverse possession and the substantiality of its claims early in the proceedings, the referee should then have sustained respondent's objections to summary jurisdiction and concluded the hearing. Therefore, there was no legal basis for the extended unilateral hearing conducted thereafter solely on petitioner's evidence on the merits. The erroneous findings of fact and conclusions of law resulting from the illegal unilateral hearing on the merits, therefore, cannot be *res judicata* in the plenary action as contended by petitioner.

Petitioner completely distorts and disregards the undisputed record when he asserts (Petn. 8-9) that respondent voluntarily submitted to summary jurisdiction. It would

be difficult to find a case in which an adverse claimant objected to summary jurisdiction as persistently as respondent did in this case. There is nothing in the record which even remotely indicates that respondent sought to reverse the referee's appointment of the receiver or that it entered into any agreement with the Court, or that it filed a motion for the return of property allegedly in the Court's possession. The Court of Appeals specifically concluded that respondent did not submit voluntarily or otherwise to summary jurisdiction.

The petition to reverse the referee's appointment of the receiver was not filed by respondent, it was filed by the largest creditors (R. 13-19). The record clearly establishes that respondent was not a party to that proceeding. Significantly, petitioner (Petn. 9) fails to inform this Court that the comments which he attributes to respondent were not made voluntarily by respondent's attorney who was merely a spectator in the courtroom but were invited by the court and were made with full knowledge by the court that respondent was objecting to summary jurisdiction (R. 1766-67). The Court of Appeals so found when it held as follows:

> "[We] have read the transcript of the proceeding before the district court on review of the appointment of receiver and are unable to agree with the district court that in its appearance and participation there Armstrong [respondent] backed off from its resistance of summary jurisdiction, or consented to the referee's decision upon the merits."

Respondent's agreement with the receiver (R. 22-23) specifically provided that respondent granted the receiver conditional use and occupancy of the building and equipment with the clear understanding that the rights of respondent as adverse claimant were to be determined as of the date of bankruptcy. Significantly, petitioner fails to

inform this Court that the order of December 7, 1962 expressly provided, as the Court of Appeals found, that respondent's rights as adverse claimant in possession must be determined as of the time of filing the bankruptcy proceeding (R. 36). Obviously, respondent did not invoke the jurisdiction of the bankruptcy court by its agreement with the receiver or through the entry of the order of December 7, 1962. There is no basis for petitioner's argument that because of respondent's agreement with the receiver and the referee's order of December 7, 1962, respondent submitted to summary jurisdiction. The Court of Appeals held precisely to the contrary.

The Court of Appeals specifically held that the district court and the referee erred in characterizing respondent's motion challenging summary jurisdiction as a reclamation petition, and concluded that respondent in filing that motion for restoration of its possession did not submit to summary jurisdiction. It is ironic, indeed, that petitioner urges (Petn. 9) that respondent in insisting that the court appointed officer must honor his agreement, thereby voluntarily submitted to summary jurisdiction. The cases hold that a receiver or trustee may not repudiate such agreements and at the same time assert rights which were made available solely thereunder. *Allison* v. *Morris Plan Co. of Tampa,* 69 F. 2d 17 (C. A. 5, 1934); *Board of Road Com'rs.* v. *Keil,* 259 Fed. 76, 81-82 (C. A. 6, 1919); *In re Display Stage Lighting Co.,* 56 F. 2d 1046 (S. D. N. Y. 1932); *United States* v. *Southern Constructors, Inc.,* 211 F. Supp. 537 (W. D. Mo. 1962).

In re Hollingsworth & Whitney Co., 242 Fed. 753 (C. A. 1, 1917), cited by petitioner (Petn. 9) does not apply because as the Court there noted, the only question under the agreement was that of ownership. Unlike respondent, the claimant in *Hollingsworth* did not challenge summary jurisdiction before or at the time the agreement was made, nor did

that agreement provide that it was without prejudice to the right to challenge summary jurisdiction.

Petitioner incorrectly argues (Petn. 7-8) that there is a conflict "in principle" between the decision of the Court of Appeals and *American Mannex Corp.* v. *Huffstutler*, 329 F. 2d 449 (C. A. 5, 1964). In *American Mannex Corp.*, the Court held on the undisputed facts that since the asserted adverse claim was obviously colorable, the claimed possession was unlawful and, therefore, the adverse claimant was subject to summary jurisdiction. Clearly, if the alleged adverse claim is not real or substantial, the possession assumed thereunder is not lawful. In the present case the Court of Appeals held that respondent's claim was not merely colorable but was real and substantial and in referring to *American Mannex Corp.*, which was cited below by petitioner, said that the facts in *American Mannex Corp.* were "widely different" from those before it, and further stated that both Courts of Appeal applied the same rules of law in reaching their respective decisions. The results were different only because the facts were different.

Petitioner erroneously states (Petn. 15) that respondent's right to take possession of its collateral is derived from one set of documents. Not only is this irrelevant to the issue before the Court but it is in complete disregard of the facts. The right to take possession of the personalty was clearly granted to respondent in three separate chattel mortgages which pertained to three separate and distinct loans made to the bankrupt over a period of six months (R. Vol. V, 53-57, 62-66, 68-73), and its right as mortgagee under its trust deed (R. Vol. V, 49-52) to take possession of the real estate was conferred by Illinois law. In *Tuttle* v. *Harris*, 297 U. S. 225, 226 (1936), this Court held that, "A mortgagee after condition broken under the law of Illinois is the owner of a legal estate, and as such entitled as of right to the possession of the mortgaged premises."

The substantiality of respondent's adverse claims and its right to take possession of its collateral are indisputably established by the various mortgages above referred to, as well as by the law of the State of Illinois as construed by this Court.

Petitioner erroneously contends here (Petn. 15) as he did below that before taking possession respondent was required to give fifteen (15) days prior notice and in support of this argument refers to a letter given by respondent to the bankrupt in connection with the loan of December 14, 1961. Not only was such notice not required by that letter but petitioner fails to inform this Court that the two subsequent chattel mortgages dated May 24, 1962 (R. Vol. V, 62-66), and June 11, 1962 (R. Vol. V, 68-73), completely superseded and nullified that letter. The two later chattel mortgages specifically provided that in the event of any default thereunder, respondent immediately was entitled to accelerate all payments due it, not only under those later mortgages and notes but all payments due it on all *prior* mortgages and notes, and to take possession without notice (R. Vol. V, p. 62, pars. 4-6; p. 63, par. 5; p. 68, pars. 4-6; p. 69, par. 5). Also, petitioner has never contended that the bankrupt could have cured its extensive defaults referred to at page 3 of this brief, if respondent had given such notice. Where service of notice would be futile, it is not required. *Rothbart* v. *Metropolitan Trust Co.*, 307 Ill. App. 271, 276, 30 N. E. 2d 183 (1940), and *Roy* v. *Goings*, 96 Ill. 361 (1880).

Petitioner asserts (Petn. 9) that the decision of the Court of Appeals conflicts with the decisions in *Buss* v. *Long Island Storage Warehouse Co.*, 64 F. 2d 338 (C. A. 2, 1933); *Teasdale* v. *Robinson*, 290 F. 2d 108 (C. A. 8, 1961); and *Fish* v. *East*, 114 F. 2d 177 (C. A. 10, 1940). *Buss* and *Fish* are not in point because in those cases the courts considered evidence on the merits only to the extent necessary

to enable them to rule on the challenges to summary jurisdiction, that is they merely conducted preliminary inquiries as required by law. Also, in *Fish*, as the Court pointed out at pages 188, 189, 193 and 194 of its opinion, the claimants clearly consented to summary jurisdiction.

Teasdale is also clearly inapplicable because the adverse claim was "... a sham and a pretense," and, as the court noted, the adverse claimant agreed to the hearings on the merits. In that case, therefore, the question of the proper scope of a preliminary inquiry was neither raised nor decided. In the context of the undisputed facts in *Teasdale*, the court's remark, "That was proper practice ...." simply and clearly means that the court may hear only so much of the facts as are necessary to determine whether the adverse claim is real and substantial or merely a sham. As soon as the court concluded that the claim was a sham and a pretense, the preliminary inquiry was concluded and the court then properly proceeded to determine the case on the merits. That the Eighth Circuit is obviously in full agreement with the Seventh Circuit on this question is firmly established by the fact that *Teasdale* cited with approval *In re Kansas City Journal-Post Co.*, 144 F. 2d 812 (C. A. 8, 1944), which was also decided by the Eighth Circuit. In *In re Kansas City Journal-Post Co.*, the Court of Appeals affirmed the district court (51 F. Supp. 1009, 1022) which rejected the contention that a preliminary inquiry is an integral, but indivisible, part of the hearing on the merits. In *In re Kansas City Journal-Post Co.*, the Court of Appeals cited and relied on *Harrison* v. *Chamberlin*.

It is very important to note that in the instant case the Court of Appeals for the Seventh Circuit cited with approval *In re Kansas City Journal-Post Co*. It is apparent, therefore, that no conflict exists between the Eighth and Seventh Circuits on this question. It is equally clear that no conflict exists among any of the circuits on this question.

All of the circuits, without exception, follow the rule of this Court in *Harrison* v. *Chamberlin.*

The decision of the Court of Appeals does not conflict in principle or otherwise with the following decisions cited by petitioner (Petn. 10): *In re Federal Photo Engraving Corp.*, 54 F. 2d 628 (C. A. 2, 1931); *Lieberman* v. *Bancroft*, 69 F. 2d 202 (C. A. 3, 1934); *Universal Oil Products Co.* v. *Cosden Petroleum Corp.*, 178 F. 2d 495 (C. A. 5, 1949); *Kelso* v. *Maclaren*, 122 F. 2d 867 (C. A. 8, 1941); *Trieber* v. *England*, 237 F. 2d 117 (C. A. 9, 1956), cert. denied, 352 U. S. 967 (1957); and *In re Christ's Church of the Golden Rule*, 172 F. 2d 523 (C. A. 9, 1949). Rather, it is apparent that these decisions are completely in accord with the ruling of the Court of Appeals in our case, because as required by *Harrison* v. *Chamberlin*, they ruled on the objections to summary jurisdiction upon completion of the preliminary inquiry. Those cases, therefore, support the decision of the Court of Appeals.

VII.

Orders Overruling Objections to Summary Jurisdiction Are Appealable.

Incredibly, petitioner argues (Petn. 10) that there is no purpose in conducting a preliminary inquiry because orders overruling objections to summary jurisdiction are not appealable. Thus, in one fell swoop petitioner conveniently nullifies all the Supreme Court cases and the extensive body of law requiring preliminary hearings.

A referee's order overruling objections to summary jurisdiction is reviewable by the district court. *Sulmeyer* v. *Pfohlman*, 329 F. 2d 915, 917 (C. A. 9, 1964); sec. 39c of the Bankruptcy Act, 11 U. S. C. A. § 67(c); 2 Collier on Bankruptcy, § 39.21, pp. 1499-1501. And the district court's order is appealable because it derives from a "proceed-

ing" (the petition to sell), rather than a "controversy." *In re Greenstreet, Inc.*, 209 F. 2d 660, 662 (C. A. 7, 1954).

Also, there is sound authority that an order overruling objections to summary jurisdiction in a controversy in bankruptcy is appealable. *Gill* v. *Phillips*, 337 F. 2d 258 (C. A. 5, 1964), (under 28 U. S. C. A. § 1292(b)).

Clearly, in bankruptcy cases appeals may be taken from orders overruling objections to summary jurisdiction. It is equally clear that there is no conflict between the decision of the Court of Appeals in this case and the decisions in the other circuits.

VIII.

The Guaranteed Right to Challenge Summary Jurisdiction May Not Be Nullified.

Petitioner contends (Petn. 7) that the referee's refusal to comply with the law and to conduct a preliminary inquiry is excusable if, despite objections to summary jurisdiction, the referee concludes after a hearing on the merits that he has summary jurisdiction over some of the property involved. Obviously, there is no merit to petitioner's contention because its effect is to nullify completely the valuable right to challenge summary jurisdiction conferred by Congress and repeatedly protected by this Court. In *Board of Education of Salt Lake City, Utah* v. *Leary*, 236 Fed. 521 (C. A. 8, 1916), which this Court cited with approval in *Harrison* v. *Chamberlin*, 271 U. S. 191, the Court of Appeals at p. 526 said:

> "If this right guaranteed by the law and uniformly recognized by the courts can be extinguished by an ultimate adverse decision on the merits, it becomes at once unsubstantial and valueless."

It is also important to note that the right of an adverse claimant to challenge summary jurisdiction is not lost

simply because some of the property of which he took possession may not be subject to his claims. This Court in *Louisville Trust Co.* v. *Comingor,* 184 U. S. 18 (1902), held that possession by an adverse claimant of property which is not subject to his claims, does not deprive him of his right to challenge summary jurisdiction as to the other property claimed and held by him. The same rule was followed in *In re Rosenberg,* 128 F. 2d 924, 926 (C. A. 7, 1942), *City and County of Denver* v. *Warner,* 169 F. 2d 508, 512 (C. A. 10, 1948), and *In re Brokol Manufacturing Company,* 221 F. 2d 640, 642-3 (C. A. 3, 1955).

Petitioner inexplicably argues (Petn. 13) that the decision of the Court of Appeals will foster illegal seizure by adverse claimants who may seek to delay administration of bankruptcy proceedings. The fact is that the decision of the Court of Appeals which complies with the mandate of *Harrison* v. *Chamberlin* and the other decisions of this Court effects an opposite result. The preliminary inquiry avoids ultimate delay because it is the sole purpose of that hearing to determine promptly whether the adverse claim is real and substantial or merely colorable. The elimination of the preliminary inquiry, as urged by petitioner, would inevitably burden future cases with the same costly, unnecessary delay that regrettably has occurred in this case.

Petitioner cannot nullify respondent's well established right to challenge summary jurisdiction and to have its rights determined in a plenary action by simply asserting that these rights are procedural (Petn. 13). Respondent is entitled to have a jury trial and has so demanded in petitioner's plenary action (R. Vol. V, 2, 94). This valuable right is unavailable in a summary proceeding. The law is well established that respondent cannot be denied its right to trial by jury on the various issues of fact common to petitioner's law and equity claims and respondent's

counterclaims and third party actions. *Beacon Theatres* v. *Westover*, 359 U. S. 500, 503-04, 510-11 (1959), *Dairy Queen, Inc.* v. *Wood*, 369 U. S. 469 (1962).

SUMMARY.

Petitioner fails to set out any special or important reason in support of his petition for the writ of certiorari.

The question presented here has been adjudicated many times by this Court in cases which were cited to the referee at the very commencement of the litigation almost four years ago. Those cases were also cited to the district court and the Court of Appeals. It was on the basis of those cases that the Court of Appeals reversed.

The Court of Appeals found that it was not the respondent but rather the petitioner who was responsible for the substantial waste and extensive delay in this case. To prevent further delay and waste, the Court of Appeals directed the parties to proceed expeditiously in the petitioner's pending plenary action. Petitioner, however, refuses to do so and argues for further delay.

It is apparent that this case involves complicated issues of fact and law affecting the rights and claims not only of petitioner and respondent but of many other persons including former officers, directors and shareholders of the bankrupt corporation who, petitioner charges, in his plenary action, misappropriated $1,438,555 of the proceeds of respondent's loans to the bankrupt. In the same plenary action, respondent charges the same officers, directors and shareholders with fraud and deceit in connection with the loans made by it to the bankrupt. Clearly, therefore, the district court in which the plenary action is pending is the ideal and only forum for determination in one trial of all of the contested, complicated issues. It is impossible to achieve this result in the summary proceeding.

It has never been denied that respondent has secured claims for $3,764,724 against the bankrupt for moneys actually loaned. Respondent has not yet had its day in court on the merits of its claims. In the plenary action, respondent filed its answer, counterclaims and third party complaint. In that action the court, with all the necessary parties before it, will adjudicate in one trial the rights and claims of all the litigants.

CONCLUSION.

It is respectfully submitted that the petition should be denied.

Respectfully submitted,

NORMAN H. NACHMAN,
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ALLAN G. SWEIG,
Attorneys for Respondent.

APPENDIX A.

IN THE UNITED STATES DISTRICT COURT
For the Northern District of Illinois,
Eastern Division.

EDWARD LIMPERIS, Successor Trustee in Bankruptcy of PROCESS-MANZ PRESS, INC., Bankrupt, *Plaintiff*, *vs.* A. J. ARMSTRONG CO., INC., a corporation; MORRIE A. MOSS, LESTER A. NEUMANN and CAROLYN D. MANZ, *Defendants.*	Civil Action No. 65 C 145

AMENDED COMPLAINT.

Now comes Edward Limperis, Successor Trustee in Bankruptcy of Process-Manz Press, Inc., Bankrupt, in Case No. 62 B 9414, now pending in the United States District Court for the Northern District of Illinois, Eastern Division, by his attorney, William S. Collen, and complaining of the defendant, A. J. Armstrong Co., Inc., a New York corporation, and defendants Morrie A. Moss, Lester A. Neumann and Carolyn D. Manz, says:

Count I.

1. Plaintiff is the Successor Trustee in Bankruptcy of Process-Manz Press, Inc., an Illinois corporation, sometimes hereinafter referred to as the "Bankrupt" or as ("Manz"). Said bankruptcy proceeding is cause No.

62 B 9414 pending in the United States District Court for the Northern District of Illinois, Eastern Division. An order of adjudication was entered against said Bankrupt in the aforementioned proceeding on January 31, 1963.

2. The defendant, A. J. Armstrong Co. Inc., (hereinafter referred to as "Armstrong") is a New York corporation engaged in the finance business. It is the successor in interest to City Industrial Company, a New York partnership, also engaged in the finance business. Armstrong had divers dealings with the Bankrupt as a financier over a protracted period of time as hereinafter set forth, not in the manner as is customary between a borrower and lender but in the manner hereinafter described.

3. Plaintiff brings this action under Section 67(e) and 70(8) (3) of the Bankruptcy Act (11 U. S. C. Sections 107(c) and 110(c) (3)). This Court has jurisdiction under said statutory provisions.

4. Manz had engaged in the printing business for over ninety years, occupying a large building situated on more than one-half city block at 4043 North Ravenswood Avenue, in Chicago, Illinois. It had been formerly known as Manz Corporation, its name having been changed to Process-Manz Press, Inc., in May 1962. Its annual volume of business was six million dollars.

5. A company known as Process Lithographers, Inc., is a New York corporation (hereinafter referred to as ("Lithographers"), was at times hereinafter referred to engaged in the printing business in New York City. It has since been adjudicated a bankrupt in a proceeding in the United States District Court for the Southern District of New York.

6. On March 20, 1961, three holders of ninety-one percent (91%) of the stock of Manz (Moss, Neumann and Kessler) entered into a written contract for the sale of

all their stock, preferred and common, to Lithographers, said contract provided for payment of $2,236,083.04 to said stockholders. One of said stockholders (Moss) was to receive payments over a period of five years. Another of said stockholders, (Neumann) was to receive payments over a four-year period. A minority (10%) third stockholder (Kessler) was to be paid in full in seven months or by October 15, 1961. Neumann was to receive a substantial payment on account ($172,833.33) on August 1, 1961. Said contract provided for the immediate resignation of all officers and directors of Manz. Said contract further provided that the purchaser would have the right to cause Manz to sell, encumber or dispose of all or any part of the assets other than in the usual course of business provided that the purchaser should pay to the selling stockholders an amount equal to one-half of the cash proceeds of any such sale or hypothecation; said contract vested full voting rights of the shareholders in Lithographers so long as there was no default.

7. New officers and directors were elected by Lithographers on or about March 20, 1961. Lithographers thereupon assumed full possession and control of and operated the business of Manz thereafter.

8. Monthly payments provided in said contract were made by Lithographers to the selling shareholders until August 1, 1961. It was unable to pay the full installment due to Neumann on August 1, 1961, of $172,833.33 and paid only $50,000.00 on account. The balance of said installment was not paid until October 16, 1961.

9. Prior to said date, on October 4, 1961, the new officers of Manz (being the same as those of Lithographers) entered into an agreement with Armstrong for a secured loan of $1,000,000.00 in behalf of Manz, out of said loan $500,000.00 was to be paid to Manz and $500,000.00 was to be held by Armstrong in escrow pursuant to authorization

granted by Moss and Neumann for the mortgaging of the assets of Manz.

10. From the proceeds of said loan of October 4, 1961, Manz advanced $289,231.75 to Lithographers, and Lithographers used the proceeds received from Manz to pay the balance due to Neumann in the sum of $172,833.33 for the installment due August 1, 1961, previously referred to.

11. After the loan of October 4, 1961 was consummated, negotiations were commenced between Armstrong and Manz for a secured loan of approximately $3,000,000.00. In the negotiation for the $3,000,000.00 loan as aforedescribed, as conditions precedent to the making of said loan, Armstrong, in addition to the security of the trust deed on the real estate and a chattel mortgage on all of the personal property of Manz, required as conditions to said loan of Manz, (1) deposit with it of one hundred percent (100%) of the shares of stock of Manz as collateral, (2) an exclusive contract for all of the financing of accounts receivable which was required to be continued in effect so long as Manz was indebted to Armstrong, and (3) the guaranty of said loan by Lithographers and by Solomon Roskin, who was President of Manz and Lithographers.

12. Pursuant to said conditions, Manz on October 31, 1961, signed a contract with Armstrong for the exclusive discounting of all its accounts receivable, Manz thereafter forwarded all of its receipts to Armstrong and Armstrong made advances to Manz in various round figures, the accounts receivable assigned to Armstrong included rents derived from the tenants of Manz.

13. Pursuant to said conditions imposed by Armstrong for the making of said loan, Lithographers, on November 6, 1961, assigned to Armstrong, all of its right, title and interest in and to its contract of March 20, 1961, for the purchase of the shares of stock of Manz, purportedly as collateral for the proposed loan. On November 6, 1961,

Lithographers delivered to Armstrong, all shares of stock of Manz paid for and acquired by it to that date. The assignment of November 6, 1961 further provided that Armstrong should have the privilege of making payments on said contract of March 20, 1961, in the event of any default by Lithographers in the payment of installments due the selling shareholders. On November 6, 1961, Lithographers confirmed by letter to Armstrong the said assignment agreement and made a commitment to use its best efforts to purchase one hundred percent (100%) of the shares of stock of Manz and to deliver said shares to Armstrong.

14. Pursuant to the conditions imposed by Armstrong, as aforesaid, the following transaction occurred on December 14, 1961. Manz executed a trust deed transferring all of its real estate and a chattel mortgage transferring all of its tangible personal property (excluding inventory and work in process) to Armstrong. Manz also executed a promissory note for $2,500,000.00 bearing interest at 12% per annum. All said documents were thereupon delivered to Armstrong. In return therefor, Armstrong on the same date, disbursed the proceeds of the $2,500,000.00 loan as follows:

(1) It repaid itself the sum of $500,000.00 borrowed from it by Manz on October 4, 1961 (and released to itself the $500,000.00 held in escrow pursuant to the loan agreement);

(2) It paid itself $11,666.67 in interest on the loan of October 4.

(3) It paid $2525.00 to its counsel for attorney's fees and title expenses.

(4) It delivered two checks payable to the order of Schwartz, Nathanson & Frank, attorneys for Manz, to George Schwartz, one check being in the amount of $814,432.58 and one for $624,122.49, said two checks being for a total amount due of $438,555.07; and

(5) It issued a check payable to Manz for $547,-253.26.

This latter check represented the actual cash proceeds received by Manz from this transaction. The two checks delivered to Schwartz were delivered on the conditions stipulated by Armstrong and under the direction of Armstrong that the amount of the first check be paid to Moss and the amount of the second check be paid to Neumann to prepay Moss and Neumann the respective total balances due to them on the contract of March 20, 1961, and that Schwartz receive in return from Moss and Neumann the balance of the shares of stock of Manz covered by these payments and deliver them to Armstrong as collateral for its loan in accordance with the terms of the loan. Upon receipt of said two checks Schwartz exchanged them for two certified checks in identical amounts payable respectively to Moss and Neumann. Schwartz then delivered these certified checks to Moss and Neumann from whom he had already obtained the remaining balance of stock (both preferred and common) and for whom he was acting as escrow agent. Schwartz delivered to Armstrong the shares of Manz stock which he had received from Moss and Neumann and thereupon certified to Armstrong that he had "this day made payment to the selling shareholders under the agreement of March 20, 1961 of the sums which we computed to be the balance provided for under said agreement", and further that in his opinion "there is no prohibition or restriction of any nature under the terms of said agreement which would prevent Manz from mortgaging its assets or assigning its accounts receivable".

15. On December 14, 1961 several creditors of Manz had substantial claims which are still due and owing.

16. As a result of the payment of $1,438.555.97 to the said selling shareholders from the proceeds of the loan

of December 14, 1961, Lithographers became indebted to Manz in said amount by reason of the fact that said payment discharged the debt of Lithographers in that amount to said shareholders and was of no benefit whatsoever to Manz. Recognizing Lithographers' inability to pay said debt to Manz, the officers and agents of Lithographers and the officers and agents of Armstrong arranged for and effected a purported redemption of preferred stock by Manz to an amount covering said debt of $1,438,555.07, plus an additional sum in excess of $500,000.00 representing cash advances and printing jobs performed by Manz for and in behalf of Lithographers. The total redemption of stock was $1,979,640.00 and cancelled a debt of Lithographers to Manz in that amount and was effected by Armstrong's surrendering shares of stock of Manz held by it in an equivalent amount to Lithographers for redemption.

17. Immediately following the consummation of said loan of December 14, 1961, Manz was in default under the terms of said loan by reason of its failure to comply with the loan requirements pertaining to minimum net working capital and minimum net worth. At the time of said loan Manz was indebted to its creditors in approximately the sum of $590,000.00 and was unable to pay its debts in the regular course of business as they became due. Prior to the time of the making of said loan of December 14, 1961 and continuously thereafter, Manz's financial condition progressively worsened from December 14, 1961 to the date of bankruptcy, November 23, 1961. On the latter date Manz was indebted to general creditors in a sum in excess of $1,000,000.00 and to wage earners in the sum of approximately $50,000.00 and to tax claimants, including withholding taxes due the United States of America in the sum of $107,000.00.

18. On November 21, 1962, Armstrong, without giving any notice to Manz, attempted to take possession of all the

property of Manz, and Armstrong, placed Pinkerton guards at the entrance to the plant and posted notices asserting that all of the premises and all of the property of Manz was in its exclusive possession.

19. On November 23, 1962, an involuntary petition in bankruptcy was filed as hereinabove described. On November 26, 1962, Francis J. Curtis was appointed Receiver. On said date an order was entered directing said Receiver to forthwith take possession of all of the property of the bankrupt. On November 27, 1962, said Receiver entered into possession of the property of Manz and continued in such possession until his appointment as Trustee on February 15, 1963. During said period the Receiver and Trustee operated the business of the bankrupt solely by reason of the request of and financial assistance from Armstrong. Edward Limperis was elected and qualified as the Successor Trustee upon the death of Francis J. Curtis.

20. By reason of the transactions hereinabove described between Manz and Armstrong, Manz did not receive "fair consideration" as defined in Section 67d of the Bankruptcy Act, since a substantial portion of its assets were mortgaged to pay the debt of Lithographers to the damage and detriment of the creditors of Manz, all with the full knowledge of Armstrong, as follows:

(a) By said transaction Manz transferred its property and incurred an obligation without fair consideration and was insolvent or was thereby rendered insolvent;

(b) Manz made a transfer and incurred a debt without fair consideration at a time when it was about to engage in such business or transaction for which the property remaining in its hands was an unreasonable small capital;

(c) Manz made a transfer and incurred a debt without fair consideration with intent on the part of its officers and agents that it would incur, or that they believed that it would incur debts beyond its ability to pay as they mature;

(d) Manz made a transfer or incurred a debt, which transfer was made and debt was incurred with actual intent to hinder, delay or defraud existing or future creditors.

All of the foregoing being in violation of Sections 67d, (2), of the Bankruptcy Act.

21. By reason of the transactions hereinabove described between Manz and Armstrong, Manz incurred an obligation and made a transfer of its property contrary to and in violation of Secton 70e of the Bankruptcy Act, which incorporates state law as grounds for invalidation. Said transfers were fraudulent and void under the laws of Illinois pertaining to fraudulent conveyances, being Ill. Rev. Stat. ch. 59, Section 4. Said transfers by Manz, together with the redemption of stock as hereinabove described, were made pursuant to a conspiracy among Armstrong, Lithographers and Manz to cause an illegal redemption in violation of Sections 6 and 58 of the Illinois Business Corporation Act, being Ill. Rev. Stat. ch. 32, Sections 157.6 and 157.58.

22. The transfers hereinabove described by Manz to Armstrong were in the form of a trust deed executed by Manz to City Industrial Co. (predecessor of Armstrong), on the real estate of the bankrupt, securing a note in the sum of $2,500,000.00, in which the Chicago Title and Trust Company is the Trustee, Identification No. 425566, and recorded as Document No. 18357738, together with a chattel mortgage executed on December 14, 1961 by Manz to City Industrial Co., securing the same note and recorded as

Document No. B3479317. Said transfers and conveyances are null and void for the reasons hereinabove stated.

23. On or about December 14, 1961, Armstrong, by reason of the transactions hereinabove described, held in excess of ninety-one percent (91%) of the shares of stock of Manz (having acquired additional shares from shareholders other than the selling shareholders) under the terms of a secured loan agreement with which it was impossible for Manz to comply and under which Manz became immediately in default; held a first and prior lien on all the assets of the bankrupt (excluding inventory and work in process); held an assignment of all accounts receivable of Manz under an agreement requiring the receipt by Armstrong of copies of all invoices representing accounts receivables created by Manz, together with all receipts of Manz. From said date, no officer or director of Manz owned or held any shares of stock of Manz, no corporate minutes of shareholders or of directors were held by Manz; all necessary authorizations for corporate action were performed without any interest or control on the part of shareholders of Manz, but at the direction of Armstrong. By reason of the foregoing, Armstrong became the owner and parent of Manz, and Manz was thereafter in effect the alter ego, tool, adjunct and instrumentality of Armstrong used for the sole purpose of advancing the financial interest of Armstrong to the great detriment and damage to the creditors of Manz.

24. On May 24, 1962 Manz executed a chattel mortgage to Armstrong, securing a note in the sum of $75,000.00, on equipment therein described. Said chattel mortgage was recorded as Document No. B-3512834. On June 11, 1962, Manz executed a chattel mortgage to Armstrong, securing a note in the sum of $10,000.00, on equipment therein described, said chattel mortgage was recorded as Document No. B-3517662. The loans secured by said chattel mort-

gages were, by reason of the matters hereinabove set forth, in substance capital contributions by Armstrong.

25. The matters set forth hereinabove are presently the subject of a summary proceeding in the aforementioned bankruptcy proceeding now pending in this Court, being Cause No. 62 B 9414. On November 27, 1963 the Honorable Lawrence J. Miller, Referee in Bankruptcy, entered an order in said cause holding that the Court had summary jurisdiction and deciding the merits of the matters presented herein and other matters. On December 4, 1964 said order of Referee Miller was affirmed, on the petition of review of Armstrong therefrom, by the Honorable William J. Campbell, Chief Judge. On December 29, 1964 Armstrong filed a notice of appeal from the judgment entered by Judge Campbell to the United States Court of Appeals for the Seventh Circuit. Said appeal is presently pending. Plaintiff files this Complaint seeking relief in the alternative in accordance with Federal Rule 8(a), solely for the purpose of preserving the rights of creditors of said bankruptcy estate, since the applicable statute of limitations, Section 11e of the Bankruptcy Act, bars any action predicated on the matters set forth herein after January 31, 1965. Plaintiff files this Complaint in accordance with the order of the Court entered January 27, 1965 authorizing and directing the filing of same solely for the purpose immediately hereinbefore stated.

Wherefore, plaintiff prays that a decree be entered by this Court ordering, decreeing and adjudging that the transfers of property by Process-Manz Press, Inc. to A. J. Armstrong Co. Inc. of December 14, 1961, of May 25, 1962 and June 11, 1962, as more particularly described hereinabove, be cancelled, set aside and declared to be null and void and of no effect whatsoever, and further that a decree be entered by this Court adjudging Manz to be the alter ego and instrumentality of Armstrong, and that Armstrong

was in effect the owner of Manz, and your plaintiff prays for such other and further relief as to the Court and equity may deem meet.

COUNT II.

1-17. Plaintiff realleges paragraphs 1-17 of Count I hereof.

18. Defendants Morrie A. Moss, Lester A. Neumann and Carolyn D. Manz were shareholders of the Bankrupt, all of whose stock had been deposited in escrow with said George Schwartz as hereinabove alleged prior to December 14, 1961.

19. On December 14, 1961 defendants Morrie A. Moss, Lester A. Neumann and Carolyn D. Manz collectively received for their said shares of stock in the Bankrupt the payments hereinabove alleged aggregating in amount $1,438,555.07.

20. On December 14, 1961 the Bankrupt was indebted to its creditors in the amount of approximately $590,000.00.

21. On December 14, 1961 the Bankrupt was insolvent and had no earned surplus, and its net assets were less than its stated capital.

22. The aforesaid payments to defendants Morrie A. Moss, Lester A. Neumann and Carolyn D. Manz made on December 14, 1961 at the direction of defendant A. J. Armstrong Co., Inc. rendered the Bankrupt insolvent and reduced its net assets below its stated capital.

23. Section 6 of The Business Corporation Act of the State of Illinois [Ill. Rev. Stat. ch. 32 § 157.6 (1961)], in effect at all times mentioned herein, provides as follows:

> "A corporation shall have power to purchase, take, receive, or otherwise acquire, hold, own, pledge, transfer, or otherwise dispose of its own shares, provided that it shall not purchase, either directly or indirectly,

its own shares when its net assets are less than the sum of its stated capital, its paid-in surplus, any surplus arising from unrealized appreciation in value or revaluation of its assets and any surplus arising from surrender to the corporation of any of its shares, or when by so doing its net assets would be reduced below such sum. Notwithstanding the foregoing limitations, a corporation may purchase or otherwise acquire its own shares for the purpose of:

(a) Eliminating fractional shares.

(b) Collecting or compromising claims of the corporation, or securing any indebtedness to the corporation previously incurred.

(c) Paying dissenting shareholders entitled to payment for their shares under the provisions of this Act.

(d) Effecting, subject to the other provisions of this Act, the retirement of its redeemable shares by redemption or by purchase at not to exceed the redemption price.

No purchase of its own shares shall be made at a time when the corporation is insolvent or when such purchase would render the corporation insolvent."

24. Section 58 of The Business Corporation Act of the State of Illinois [Ill. Rev. Stat. ch. 32, § 157.58 (1961)], in effect at all times mentioned herein, provides in part as follows:

"No redemption or purchase of redeemable shares shall be made which will reduce the remaining assets of the corporation below an amount sufficient to pay all debts and known liabilities of the corporation as they mature, except such debts and liabilities as have been otherwise adequately provided for, or which will reduce the net assets below the aggregate amount payable to the holders of shares having prior or equal rights to the assets of the corporation upon dissolution."

25. The aforesaid payments to defendants Morrie A. Moss, Lester A. Neumann and Carolyn D. Manz on December 14, 1961 were in violation of Sections 6 and 58 of the Illinois Business Corporation Act [Ill. Rev. Stat. ch. 32, §§ 157.6 and 157.58 (1961)].

26. By virtue of § 70e of the Bankruptcy Act, said Sections 6 and 58 of the Illinois Business Corporation Act and the common law of Illinois, particularly as declared in *Reilly* v. *Segert*, 31 Ill. 2d 293 (1964), plaintiff, as representative of the creditors of said bankrupt, is entitled to recover the aforesaid payments to defendants Morrie A. Moss, Lester A. Neumann and Carolyn D. Manz.

27. The matters set forth hereinabove are presently the subject of a summary proceeding in the aforementioned bankruptcy now pending in this Court, being Cause No. 62 B 9414. Plaintiff files this Complaint seeking relief in the alternative in accordance with Federal Rule 8(a) in the event that it is finally determined plaintiff is not entitled to relief in said summary proceeding.

Wherefore, Plaintiff prays judgment against defendant Morrie A. Moss in the amount of $814,432.58 and against defendants Lester A. Neumann and Carolyn D. Manz in the amount of $624,122.49, together with costs of this suit.

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